



GOVERNOR'S OFFICE OF
 BUDGET AND PROGRAM PLANNING

Fiscal Note 2009 Biennium

Bill # HB0356

Title: Reduce property taxes by changes in state aid to schools

Primary Sponsor: Lange, Michael

Status: As Introduced

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|--|---|--|
| <input checked="" type="checkbox"/> Significant Local Gov Impact | <input checked="" type="checkbox"/> Needs to be included in HB 2 | <input type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input checked="" type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

FISCAL SUMMARY

	<u>FY 2008 Difference</u>	<u>FY 2009 Difference</u>	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>
Expenditures:				
General Fund (01)	\$65,980,208	\$66,392,986	\$67,113,133	\$67,991,446
Revenue:				
General Fund (01)	(\$129,196,255)	(\$129,713,032)	(\$133,104,257)	(\$135,606,604)
Net Impact-General Fund Balance:	<u>(\$195,176,463)</u>	<u>(\$196,106,018)</u>	<u>(\$200,217,390)</u>	<u>(\$203,598,050)</u>

Description of Fiscal impact: HB 356: (1) increases the direct state aid percentage from 44.7% of the basic and per-ANB entitlements to 50.0% of the basic and per-ANB entitlements; (2) decreases the statewide 40 mill levy to 15 mills; and (3) provides an income tax credit based on residential property values. Because of the lowering of property taxes for all classes, there is an impact to individual income tax and corporation license tax revenues in all years.

FISCAL ANALYSIS

Assumptions:

- HB 356 increases the direct state aid percentage from 44.7% of the basic and per-ANB entitlements to 50.0% of the basic and per-ANB entitlements.
- Under current law, the average number belonging in K-12 public schools will be as follows:

	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>
K-6 ANB	72,763	72,001	71,899	72,530	73,704
7-8 ANB	24,643	23,745	22,980	22,199	21,821
9-12 ANB	<u>49,613</u>	<u>49,187</u>	<u>48,613</u>	<u>47,910</u>	<u>46,798</u>

Total	147,019	144,933	143,492	142,639	142,323
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3. The basic and per-ANB entitlements in HB 356 do not change from the FY 2007 amounts. The basic and per-ANB entitlements will change as will the DSA percentage as follows:

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Basic entitlement EL	\$20,718	\$20,718	\$20,718	\$20,718	\$20,718
Basic entitlement HS	\$230,199	\$230,199	\$230,199	\$230,199	\$230,199
Per-ANB entitlement EL	\$4,456	\$4,456	\$4,456	\$4,456	\$4,456
Per-ANB entitlement HS	\$5,704	\$5,704	\$5,704	\$5,704	\$5,704
DSA Percentage	44.7%	50.0%	50.0%	50.0%	50.0%

4. The 5.3% increase in DSA will increase state funding in BASE budgets for quality K-12 public schools by \$40.98 million in FY 2008 and \$40.54 million in FY 2009 with an on-going DSA increase of \$40 million per year at the entitlement rates in assumption 3.
5. There will be no increased retirement expense created by changes in SB 152.
6. Consistent with HJR 2 revenue estimates, the statewide taxable valuations will increase by 3.18% in FY 2008 and 3.22% in FY 2009 and beyond.

Property Tax

7. Section 3 of this bill reduces the current law 40 statewide mills on property for state equalization aid to 15 mills. This property tax reduction will decrease the general fund revenue by \$50.4 million in FY 2008, \$52.0 million in FY 2009, \$55.2 million in FY 2010, and \$57.0 million in FY 2011.
8. Combined with the local mill levy impact shown in the section titled "effect on County or Other Local Revenues or Expenditures" the total reduction in property tax is \$43.7 million for CY 2007, \$89 million for CY 2008, \$90.8 million for CY 2009, and \$93.1 million for CY 2010.
9. The total reduction in property tax is \$88.6 million for FY 2008, \$89.0 million for FY 2009, \$92.2 million for FY 2010, and \$94.0 million for FY 2011.

Income Tax – DOR assumptions

10. Section 1 of this bill provides a refundable tax credit to residential property taxpayers who occupy their residence at least 7 months during the year. The credit is equal to the taxable property value of the income tax year times 3.8% subtracted from \$400. The following table shows the income tax credit by selected house market values.

Illustration of Credit with Different House Market Values & Using FY 2006 Tax Rate				
	Example 1	Example 2	Example 3	Example 4
Market value (MV)	\$60,000	\$120,000	\$240,000	\$480,000
Minus residential exemption (32%)	(19,200)	(38,400)	(76,800)	(153,600)
Adjusted MV after residential exemption	\$40,800	\$81,600	\$163,200	\$326,400
Times applicable tax rate (2006)	3.22%	3.22%	3.22%	3.22%
Taxable value	\$1,314	\$2,628	\$5,255	\$10,510
Maximum tax credit	\$400.00	\$400.00	\$400.00	\$400.00
Taxable value times 3.8%	\$49.92	\$99.85	\$199.69	\$399.38
Credit (\$400 - Taxable value times 3.8%)	\$350.08	\$300.15	\$200.31	\$0.62

11. Based on figures from the 2005 American Community Survey, there are 254,458 owner-occupied houses in Montana. A sample of 254,458 residential parcels was drawn from the Department's MODS system, and the income tax credit was calculated for each parcel, based on its actual calendar year 2006 Class 4 residential property taxable value. This fiscal note assumes that for most owner-occupied homeowners, this taxable value represents the allowable property (residential improvement and land) on which the credit is based.
12. Based on the sample properties using calendar year 2006 values phased up calendar year 2007 values, the estimated total taxable value is \$560,528,457.
13. Taxpayers whose properties have taxable values of more than \$10,526 ($\$400 / 3.8\%$) will not receive credits. There are 1,502 taxpayers with properties over this threshold, leaving 252,956 properties that would be eligible for the income tax credit.
14. The value of the 252,956 residential properties was grown using the growth rate of taxable value assumed in HJR 2. Then total credits were estimated for the entire group of residential properties and the result is \$80,816,966 for tax year 2007 and \$80,879,839 for tax year 2008. Growth in the total estimated credit amounts from calendar year 2007 to calendar year 2008 is 1% ($\$80,879,839 / \$80,816,966$) and is due to new properties being added to the tax rolls. Using this 1% annual growth rate, the estimated credit amounts would be \$81,688,637 for calendar year 2009 and \$82,505,524 for calendar year 2010.
15. Credits will be claimed on tax returns filed in the spring following the tax year. This bill applies to property assessed and billed in calendar year 2007, with the first year of credits claimed in FY 2008. General fund revenue will be reduced by \$80,816,966 in FY 2008, \$80,879,839 in FY 2009, \$81,688,637 in FY 2010 and \$82,505,524 in FY 2011.
16. Individual taxpayers who take an itemized deduction for property taxes will have a smaller deduction beginning with calendar year 2007 because of this bill. The average percent reduction due to the mill levy changes in assumption 11 will be 8.2244%.
17. Individual taxpayers whose credits are greater than their income tax liability will receive a refund. Taxpayers will receive the first refunds, for calendar year 2007, in FY 2008. Taxpayers will be required to report these refunds as income on their federal income tax returns. Taxpayers who take itemized deductions for property taxes and state income taxes on their federal returns will have smaller deductions. For taxpayers who take an itemized deduction for federal taxes of less than the cap of \$5,000 (\$10,000 for married filing a joint return), this will increase their deduction, reducing their state tax liability.
18. The income tax revenue estimating program was run with the following changes to the 2005 income tax returns database.
 - All of the 192,268 returns with an itemized deduction for property taxes had the deduction reduced by 8.2244%.
 - For all returns with a property tax deduction, the current law taxable value of the property was calculated by dividing the deduction amount by the average statewide mill levy, 526.329, and then multiplying by 1,000. The corresponding credit amount was then calculated.
 - A random sample of 62,190 returns ($254,458 - 192,268$) with no property tax deduction was selected. Each of these returns was assigned a credit amount based on the total household income reported on the return and a statistical relationship between taxable value and total household income for the returns with a property tax deduction.
 - For all returns with a credit amount assigned, tax liability was subtracted from the credit. If the difference was positive, it was used as the refund amount to add to federal adjusted gross income, beginning in FY 2008.
19. Compared to the results of running the program with the un-modified 2005 income tax returns database, tax liability was higher by \$1.466 million in 2007, \$1.515 million in 2008, \$1.568 million in 2009, and \$1.632 million in 2010. These changes in tax liability are due to changes in deductions that will be calculated when taxpayers file their returns in the spring following the tax year. Therefore, the

corresponding revenue increases caused by the changes in the deductions will occur in FY 2008 through FY 2011.

Corporation License Tax

20. With lower property taxes, businesses will have lower property tax expenses to deduct in calculating taxable net revenue. Businesses would receive 54.8% of the property tax reductions in assumption 9. The total reduction would be \$24660,000 in 2007, \$48,772,000 in 2008, \$49,758,400 in 2009, and \$51,018,800 in 2010.
21. Corporations that do business in Montana and other states are required to report their Montana property on their corporation license tax returns. Of this property, 66.65% was reported by corporations that had positive taxable income. It is assumed that the same proportion of total business property is owned by businesses with positive net income.
22. The corporation license tax rate is 6.75%. It is assumed that the average marginal tax rate on business income reported on individual income tax returns is also 6.75%. The change in tax liability will be \$1,109,423 for tax year 2007 ($6.75\% \times \$24,660,000 \times .6665$), \$29,194,191 for tax year 2008 ($6.75\% \times \$48,772,000 \times .6665$), \$2,238,568 for tax year 2009 ($6.75\% \times \$49,758,400 \times .6665$), and \$2,295,272 for tax year 2010 ($6.75\% \times \$51,018,800 \times .6665$).
23. Both corporations and individuals with business income frequently use the option for an extended deadline for filing tax returns. Because of this, the changes in tax liability in assumption 25 will be reported on tax returns filed over the course of the following calendar year, with half of the change coming in the fiscal year including the last half of the tax year and half coming in the next fiscal year. General fund revenue will be increased by \$554,711 in FY 2008 ($\frac{1}{2} \times \$1,109,423$), by \$1,651,807 in FY 2009 ($\frac{1}{2} \times \$1,109,423 + \frac{1}{2} \times \$2,194,191$), by \$2,216,380 in FY 2010 ($\frac{1}{2} \times \$2,194,191 + \frac{1}{2} \times \$2,238,568$), and by \$2,266,920 in FY 2011 ($\frac{1}{2} \times \$2,238,568 + \frac{1}{2} \times \$2,295,272$).

Total Revenue

24. The following table shows the changes in general fund revenue:

	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>
Property Tax	(\$50,400,000)	(\$52,000,000)	(\$55,200,000)	(\$57,000,000)
Income Tax Credit	(\$80,816,966)	(\$80,879,839)	(\$81,688,637)	(\$82,505,524)
Income Tax Deductions	\$1,466,000	\$1,515,000	\$1,568,000	\$1,632,000
Corp Tax	<u>\$554,711</u>	<u>\$1,651,807</u>	<u>\$2,216,380</u>	<u>\$2,266,920</u>
Total	<u>(\$129,196,255)</u>	<u>(\$129,713,032)</u>	<u>(\$133,104,257)</u>	<u>(\$135,606,604)</u>

Tax Administration

25. The Department of Revenue will require 0.50 additional FTE to assist taxpayers in verifying the taxable value of property to use in calculating their credit and 1.00 additional FTE to process and audit returns claiming the credit. Total personal services costs will be \$67,710 per year. Start-up costs for office furniture and equipment will be \$11,800 in FY 2008. Operating costs will be \$10,996 in FY 2008 and \$11,892 per year in FY 2009 through FY 2011.

<u>Fiscal Impact:</u>	<u>FY 2008 Difference</u>	<u>FY 2009 Difference</u>	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>
FTE	1.50	1.50	1.50	1.50
<u>Expenditures:</u>				
Personal Services	\$67,710	\$67,710	\$67,710	\$67,710
Operating Expenses	\$10,996	\$11,892	\$11,892	\$11,892
Equipment	\$11,800	\$0	\$0	\$0
Local Assistance (Direct State Aid)	\$40,978,251	\$40,537,788	\$40,226,911	\$40,032,959
Transfers	\$24,911,451	\$25,775,596	\$26,806,620	\$27,878,885
TOTAL Expenditures	\$65,980,208	\$66,392,986	\$67,113,133	\$67,991,446
<u>Funding of Expenditures:</u>				
General Fund (01)	\$65,980,208	\$66,392,986	\$67,113,133	\$67,991,446
TOTAL Funding of Exp.	\$65,980,208	\$66,392,986	\$67,113,133	\$67,991,446
<u>Revenues:</u>				
General Fund (01)	(\$129,196,255)	(\$129,713,032)	(\$133,104,257)	(\$135,606,604)
TOTAL Revenues	(\$129,196,255)	(\$129,713,032)	(\$133,104,257)	(\$135,606,604)
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>				
General Fund (01)	(\$195,176,463)	(\$196,106,018)	(\$200,217,390)	(\$203,598,050)

Effect on County or Other Local Revenues or Expenditures:

1. The increase in the direct state aid percentage to 50.0% from 44.7% will increase the 80% BASE budget to 85.3%. This could decrease over-BASE local tax levies by the \$38.22 million in FY 2008, \$37.49 million in FY 2009, with an on-going tax savings of about \$37 million in FY 2010 and FY 2011.
2. Local tax increment financing (TIF) districts would see a loss in revenues due to the reduction in the state equalization mills. Under current law, TIFs are able to retain the mill levy revenue associated with the 95 mills which this law would reduce to 70 mills.

Long-Range Impacts:

1. Should the changes to state equalization mills and direct state aid continue beyond 2011, there will continue to be significant reductions in the state general fund revenues and increased expenditures.

Technical Notes:

1. If the sponsor's intention is to keep BASE aid at 80 % of the entitlements, then Section 2 (Page 2, lines 11 and 12) of the bill, the definition of "BASE aid" needs to be amended to include guaranteed tax base aid for the district for any amount up to 30% of the basic entitlement and 30% of the total per-ANB entitlement.

Sponsor's Initials_____
Date_____
Budget Director's Initials_____
Date